



Treasury Trends

Bringing currency to the Arizona Taxpayer

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This month's
character trait ---

Wisdom:
*Seeing and
responding to life
situations from a
perspective that
transcends my
current
circumstances*

**Both LGIP Pools
continue to
outperform their
benchmarks in
January 2004**

**Home Ownership
on the rise in the
U.S.**

LGIP Performance

The Board of Investment, in the regular meeting held on February 18, 2004 was informed of the performance of the LGIP and LGIP-Gov pools. Both pools continued to outperform their benchmarks. Balances of the pools also remained relatively stable for the month.

<i>Yields</i>	LGIP	LGIP Index	Diff	LGIP-GOV	3 mo. T-Bill	Diff
Pool size →	\$2.6 B			\$1.1 B		
January '04	1.41	.85	+.56	.98	.89	+.09
Feb '03	1.48	1.11	+.37	1.24	1.18	+.06
March '03	1.59	1.09	+.50	1.35	1.14	+.21
April '03	1.62	1.06	+.56	1.18	1.14	+.04
May '03	1.73	1.03	+.70	1.21	1.08	+.13
June '03	1.88	.99	+.89	1.54	.93	+.61
July '03	1.58	.85	+.73	1.44	.90	+.54
August '03	1.51	.83	+.68	.97	.96	+.01
September '03	1.48	.83	+.65	.97	.95	+.02
October '03	1.43	.83	+.60	.97	.93	+.04
November '03	1.43	.85	+.58	.99	.94	+.05
December '03	1.44	.88	+.56	.98	.90	+.08

Nationwide Perspective

A Nation of Homeowners

The percentage of people in the U.S. who are homeowners is increasing. Despite rising real estate prices, reduced mortgage rates have made home ownership more affordable. In 2003, surpassing the record set in 2002, 68.3% of households in the U.S. were homeowners. The increase was felt in most demographic segments of the economy. The percentage of minorities who were homeowners, also surpassed the previous record, reached 49.5% in 2003. The combination of low interest rates and long mortgage periods (30 years) allows some to buy homes for the same or less than the monthly cash outflow of renting comparable housing.

However, home equity may not be rising as rapidly as anticipated. The low interest rates have also encouraged refinancing existing mortgages. Approximately 1/3 of refinance transactions include pulling equity out of the home.

Fed Governor Bies warns against extending too far out on the yield curve.

Bond duration is an indicator of volatility

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What is the Federal Reserve Saying?

Governor Susan Schmidt Bies:

"... I want to simply note the historically low level of interest rates which are not within the work experience of many investment and risk managers. The typical response is to try to increase nominal yields and widen spreads. Thus, some ... have acted to extend portfolio durations and accept risk, given the steep yield curve, because statistics will likely tell you that the odds of a rate increase are greater than a further decline. We are also seeing some investors attempt to increase nominal yields by investing in lower-rated bonds. ...the goal should be appropriate "risk management," that is, given an organization's risk appetite, **the attractiveness of higher yields must always be balanced against the increased level of risk in the transaction.** And in times of turns in business and interest rate cycles, estimating these tradeoffs can be more difficult. That is not a prediction of near or future rate movements--just advice from an experienced manager of interest rate risk."

Translation: Avoid going too far out on the curve in search of yield in this low interest environment. Few managers have experience in this type of environment.

Duration ... What is it?

In its most simplistic explanation, duration is a calculation which gives an indication when a bond investor receives all their money back through coupon payments and/or principle payments. For example: Buying a 20 year bond at par with a 10% annual coupon, I would, theoretically receive all my original investment after the 10th annual coupon payment. (10 years @ 10%/yr = 100%) So, the duration of that bond would be approximately 10 years. Consequently, the duration of a zero coupon bond will always be the length of maturity because there are no coupon payments to repay the investor ... all the money comes back at maturity. Of course, nothing is simple in finance. In the first bond example, each coupon payment is reinvested and the interest earned further affects the duration.

One useful "rule of thumb" with duration is "for every 1% move in interest rates, a bond will fluctuate in value equal to it's duration." Example: A bond with a duration of 10 will move up or down 10% for each 1% change in Yield to Maturity. So, if interest rates go up by 1%, that bond will lose 10% in value. A bond with a duration of 5 would move down half as much. This is an extremely simplistic explanation which may give you a basic idea about bond duration. It also explains why short duration is a conservative strategy when facing potentially rising interest rates.

Yield Curve Perspective

Treasury Yield Curve				
Term	25 Feb	1 Week Earlier	1 Month Earlier	1 Year Earlier
3 mo.	.96	.93	.90	1.19
6 mo.	1.01	.98	.96	1.19
2 yr.	1.60	1.68	1.68	1.55
3 yr.	2.14	2.20	2.20	N/A
5 yr.	2.96	3.02	3.02	2.78
10 yr.	4.01	4.05	4.05	3.82
30 yr.	4.88	4.91	4.98	4.78

